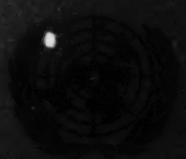
World Investment Report

1997

Transnational Corporations, Market Structure and Competition Policy

Overview



United Nations

United Nations Conference on Trade and Development

World Investment Report 1997

Transnational Corporations, Market Structure and Competition Policy

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United Nations
New York and Geneva, 1997

Note

UNCTAD serves as the focal point within the United Nations Secretariat for all matters related to foreign direct investment and transnational corporations. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). In 1993, the Programme was transferred to the United Nations Conference on Trade and Development. UNCTAD seeks to further the understanding of the nature of transnational corporations and their contribution to development and to create an enabling environment for international investment and enterprise development. UNCTAD's work is carried out through intergovernmental deliberations, technical assistance activities, seminars, workshops and conferences.

The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable;

A slash (/) between dates representing years, e.g., 1994/95, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g., 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

The material contained in this study may be freely quoted with appropriate acknowledgement.

UNCTAD/ITE/IIT/5 (Overview)

Acknowledgements

The *World Investment Report 1997* was prepared by a team led by Karl P. Sauvant and comprising Victoria Aranda, Philippe Brusick, Sew Sam Chan Tung, Persephone Economou, Wilfried Engelke, Masataka Fujita, Massimiliano Gangi, Michael Gestrin, Kálmán Kalotay, Michael Lim, Padma Mallampally, Ludger Odenthal, Assad Omer, Jenniter Powell, Luisa Sabater, Anh Nga Tran-Nguyen, Jorg Weber and James Xiaoning Zhan. Specific inputs were received from Menelea Masin and Joseph Mathews. The work was carried out under the overall direction of Lynn K. Mytelka.

Principal research assistance was provided by Mohamed Chiraz Baly, Makameh Bahrami, Antonella Convertino, Siri Dalawelle, Lizanne Martinez and Mohamed Berrada. A number of interns assisted at various stages during the preparation of *WIR 97*: Btisame Boudhan, Christian Caruso, Rikke Mortensen and Stefanie Ten Napel. Production of the *Report* was carried out by Jeniter Tacardon, Amanda Waxman, Florence Hudry, Christiane Detrancisco and Corazon Alvarez. Graphics were done by Diego Oyarzun-Reyes. It was desktop-published by Teresita Sabico. The *Report* was edited by Guy de Jonquières and copy-edited by Frederick Glover.

Experts from within and outside the United Nations system provided inputs for *WIR 97*. Major inputs were received from Joel Davidow and Colm MacKernan, Stephen W. Davies and Bruce Lyons, Edward M. Graham, Donald L. Lecraw, Bijit Bora, Miguel Rodriguez Mendoza, Dieter Ernst, Fabrice Hatem and Peter Nunnenkamp. Inputs were also received from Anna Joubin-Bret, Alvaro Calderón, Basanta Chaudhuri, Terry M. Chuppe, Carlo Gamberale, Tim Kelly, Roger Lawrence, Marcus Noland, Mary Stanier, Lee Tuthill and Terry Winslow.

A number of experts were consulted on various chapters. Comments were received during various stages of preparation (including during expert group meetings) from Jamuna P. Agarwal, Thomas Andersson, Pierre Arbel, Milos Barutciski, Michael Blank, Thomas Brewer, John Cantwell, Jenny Cargill, S. Y. Cochrane, Brian Craig, Claudia Curiel , Rajan Dhanjee, Michel Delapierre, Arghyros A. Fatouros, Geza Feketekuty, Maxwell Fry, Cathy Goddard, Calvin S. Goldman, Karin Gollan, H. Peter Gray, Chris Hall, Khalil Hamdani, Gary Hewitt, Silke Hossentelder, Michael L. Howell, Himmat Kalsi, Jorge Katz, Faizullah Khilji, Fred Kilby, Friedrich von Kirchbach, Mark Koulen, Nagesh Kumar, B. P. Kunene, Sanjaya Lall, Richard Lipsey, P.J. Lloyd, Gavin Maasdorp, Jorge Maia, Raymond Mataloni, Rose Mystila, Adrian Otten, Alan Oxley, Terutomo Ozawa, D.J. Pathirana, E.U. Petersmann, Hassan Qaqaya, Claude Rakovsky, Eric D. Ramstetter, Pedro Rotie, Pierre Sauvé, Marjan Svetlicic, Shigeki Tejima, Stephen Thomsen, Hans Ullrich, Meg Vorhees, Sarah W. Wainaina, Mark Warner, Larry Westphal, Obie Whichard, Crystal Witterick, Americo Beviglia Zampetti and Zbigniew Zimny.

This year, *World Investment Report* benefited from comments and discussions on its theme received through an INTERNET conference on the AIBnet organized by Tagi Sagafi-nejad. Pontus Braunerhjelm, Gunnar Fors, Virginia Brown Keyder, Sylvia Ostry, Howard V. Perlmutter, Lee Preston, Val Samonis and Raymond Vernon shared their views through this process.

The Australian APEC Study Centre, the Asian Business Centre at Melbourne University and the Victoria University of Technology organized a roundtable on foreign direct investment and competition policy in connection with *WIR 97*.

Especially through the provision of data and other information, numerous officials in Central Banks, statistical offices, competition authorities, investment promotion agencies and other government offices, as well as executives of a number of companies, also contributed to *WIR 97*.

The *Report* benefited from overall advice from John H. Dunning, Senior Economic Adviser.

The financial support of the Governments of the Netherlands and Norway, and of Hong Kong, are gratefully acknowledged.

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World Investment Report 1997:

Transnational Corporations, Market Structure and Competition Policy

Overview

Foreign direct investment (FDI) continues to be a driving force of the globalization process that characterizes the modern world economy. The current boom in FDI flows, which has been accompanied by increasing flows of foreign portfolio equity investments, underscores the increasingly important role played by transnational corporations (TNCs) in both developed and developing countries. This role has been facilitated by the liberalization of FDI policies that has taken place in many countries in recent years, as part of an overall movement towards more open and market-friendly policies. However, reaping the benefits of FDI liberalization requires not only that barriers to FDI are reduced and standards of treatment established — the focus of most FDI liberalization to date — but also that competition in markets is maintained. This third component of FDI liberalization — maintaining the proper functioning of markets in which TNCs invest — is the special topic of this year's *World Investment Report*, which examines the interaction between FDI, market structure and competition, and looks at policy implications.

GLOBAL AND REGIONAL TRENDS

The growing size and importance of international production ...

With some $6.4 trillion in global sales in 1994 (and estimated global sales of $7 trillion in 1995) -- the value of goods and services produced by some 280,000 foreign affiliates -- international production outweighs exports as the dominant mode of servicing foreign markets (table 1). The growth of global sales has exceeded that of exports of goods and services by a factor of 1.2 to 1.3 since 1987. But as far as developing countries are concerned, despite their growing involvement in international production — of the world's 44,000 parent firms, 7,900 firms were based in developing countries in the mid-1990s (table 2), compared to 3,800 in the late 1980s — exports continue to be the principal mode of delivering goods and services to foreign markets.

The gross product of foreign affiliates, a measure of their output, almost tripled between 1982 and 1994, and its share of world output rose slightly, from 5 per cent in 1982 to 6 per cent in 1994. In developing countries, the output of foreign affiliates has contributed (in 1994) more to gross domestic product than it has in developed countries: 9 per cent compared to 5 per cent.

The global FDI stock, a measure of the investment underlying international production, increased fourfold between 1982 and 1994; over the same period, it doubled as a percentage of world gross domestic product to 9 per cent. In 1996, the global FDI stock was valued at $3.2 trillion. Its rate of growth over the past decade (1986-1995) was more than twice that of gross fixed capital formation, indicating an increasing internationalization of national production systems. The worldwide assets of foreign affiliates, valued at $8.4 trillion in 1994, also increased more rapidly than world gross fixed capital formation.

The upward trend manifested in all of the indicators of international production, in absolute terms as well as in relation to various macroeconomic indicators, suggests that international production is becoming a more significant element in the world economy. Its importance is apparent in the activities in which TNCs

Table 1. Selected indicators of FDI and international production, 1986-1996

(Billions of dollars and percentage)

Item	Value at current prices (Billion dollars)		Annual growth rate (Per cent)			
	1995	1996	1986-1990	1991-1996	1995	1996
FDI inflows	317	349	24.4	17.1	32.6	10.3
FDI outflows	339	347	27.0	11.8	34.9	2.4
FDI inward stock	2 866	3 233	18.7	11.7	18.2	12.8
FDI outward stock	2 811	3 178	19.8	11.1	15.1	13.1
Cross-border mergers and acquisitions[a]	141	163	21.0[b]	27.1	28.8	15.5
Sales of foreign affiliates	5 933[c]	6 412[d]	17.3	4.0[e]	12.5[c]	8.1[d]
Gross product of foreign affiliates	1 363[c]	1 557[d]	19.1	3.3[e]	-2.9[c]	14.2[d]
Total assets of foreign affiliates	7 091[c]	8 343[d]	19.9	11.2[e]	13.1[c]	17.7[d]
Memorandum						
GDP at factor cost	28 264	30 142	10.7	6.4	9.5	6.6
Gross fixed capital formation	6 088	..	10.7	4.5[f]	12.4	..
Royalties and fees receipts	48	..	21.9	12.0[f]	16.4	..
Exports of goods and non-factor services	5 848	6 111	14.3	7.4	16.2	4.5

Source: UNCTAD, *World Investment Report 1997*, p. 4.

[a] Majority-held investments only.
[b] 1987-1990.
[c] 1993.
[d] 1994.
[e] 1991-1994.
[f] 1991-1995.

Note: not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and the sales of the parent firms themselves.

Table 2. Number of parent corporations and foreign affiliates, by area and country, latest available year

(Number)

Area/economy	Parent corporations based in country	Foreign affiliates located in economy [a]
Developed countries	36380	93628
Western Europe	26161	61902
European Union	22111	54862
Japan	3967 [b]	3405 [c]
United States	3470 [d]	18608 [e]
Developing countries	7932	129771
Africa	30	134
Latin America and the Caribbean	1099	24267
South, East and South-East Asia	6242	99522
West Asia	449	1948
Central and Eastern Europe	196	53260
World	44508	276659

Source: UNCTAD, *World Investment Report 1997*, p. 6.

a Represents the number of foreign affiliates in the economy shown, as defined by it (see section on definitions and sources in the annex).

b The number of parent companies not including finance, insurance and real estate industries in March 1995 (3,695) plus the number of parent companies in finance, insurance and real estate industries in December 1992 (272).

c The number of foreign affiliates not including finance, insurance and real estate industries in March 1995 (3,121) plus the number of foreign affiliates, insurance and real estate industries in November 1995 (284).

d Represents a total of 2,658 non-bank parent companies in 1994 and 89 bank parent companies in 1989 with at least one foreign affiliate whose asset, sales or net income exceeded $3 million, and 723 non-bank and bank parent companies in 1989 whose affiliate(s) had assets, sales and net income under $3 million.

e Represents a total of 12,523 bank and non-bank affiliates in 1994 whose assets, sales or net income exceeded $1million, and 5,551 bank and non-bank affiliates in 1992 with assets, sales and net income under $1 million, and 534 United States affiliates that are depository institutions. Each affiliate represents a fully consolidated United States business entreprise, which may consist of a number of individual companies.

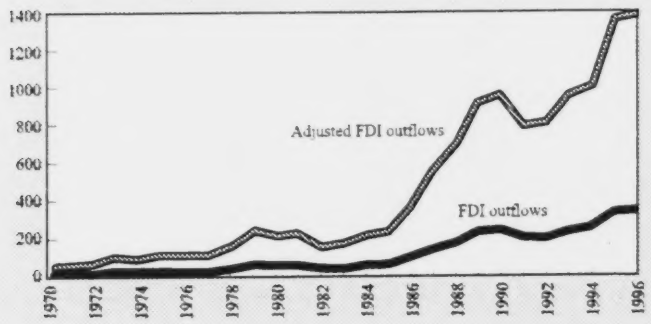
Note: the data can vary significantly from preceding years, as data become available for countries that had not been covered before, as definitions change, or as older data are updated.

are involved. On the technology side, for example, an estimated 70 per cent of the global payments of royalties and fees constitute transactions between parent firms and their foreign affiliates.

... was manifested in 1996 in the $1.4 trillion worth of investment in foreign affiliates.

Transnational corporations raise capital from a variety of sources at home and abroad: commercial banks, local and international equity markets, public organizations and their own corporate systems in the form of internally generated profits for reinvestment. Taking all these sources of finance into account, investment in foreign affiliates — the investment component of international production — was an estimated $1.4 trillion in 1996 (figure 1). Of this, only $350 billion, i.e., a quarter, were financed by FDI flows. This means therefore that the weight of international production is also considerably larger: expressed as a ratio of world gross fixed capital formation, about one-fifth was undertaken by foreign affiliates. (This measure does not capture additional investment controlled by TNCs via various non-equity measures, including corporate alliances.)

Figure 1. Actual flows of investment abroad by TNCs, 1970-1996
(Billions of dollars)

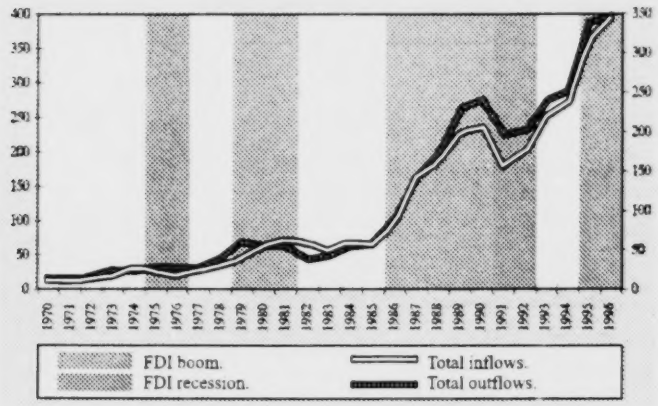


Source: UNCTAD, *World Investment Report 1997*, p. 27.

Foreign-direct-investment flows set a new record level of $350 billion, in the midst of a new FDI boom, ...

Returning to FDI flows themselves, the boom that began in 1995 continues, with inflows setting a new record of around $350 billion in 1996, a 10 per cent increase (figure 2). Fifty four countries on the inflow side and twenty countries on the outflow side set new records in 1996. Unlike the two previous investment booms in 1979-1981 and 1987-1990 (the first one being led by petroleum investments in oil producing countries, and the second one being concentrated in the developed world), the current boom is characterized by considerable developing-country participation on the inflow side, although it is driven primarily by investments originating in just two countries — the United States and the United Kingdom. There are signs that an even greater number of countries will take part in the present boom as it unfolds on the inward side (e.g., developing countries in Latin America), as well as on the outward side (e.g., France, Germany and Asian developing countries).

Figure 2. Growth of domestic and foreign direct investment, 1980-1996
(Index, 1980=100)



Source: UNCTAD, *World Investment Report 1997*, p. 11.

During 1995-1996, the share of developing countries in global inflows was 34 per cent. Although this is not much higher than the developing-country share during the investment boom at the beginning of the 1980s, qualitatively it reflects a wide variety of location-specific advantages enjoyed by developing countries over and above natural resources. The composition of the top developing-country recipients has also changed dramatically between these two investment booms, with oil producing countries now featuring far less prominently among the top recipients. Interestingly, the developing-country share of global inflows has been on the rise during the current boom, while during the 1987-1990 boom it declined. That decline went hand in hand with a boom in intra-developed country mergers and acquisitions (M&As), at that time in response to heightened protectionist pressures in key developed countries. As in earlier FDI booms, the bulk of FDI flows goes to a limited number of developing countries.

... with cross-border mergers and acquisitions and inter-firm agreements as the driving force behind TNC activity ...

Even in the current boom, cross-border M&As, especially in the United States and Western Europe, are playing an important role in boosting FDI, although this time there is no ensuing decline in the developing-country share of inflows. The value of such M&As increased by 16 per cent in 1996, to $275 billion. If majority-held transactions only are taken into account, the value of cross-border M&As in 1996 would be $163 billion, or 47 per cent of global FDI inflows (though the measured values are not strictly comparable) (figure 3).

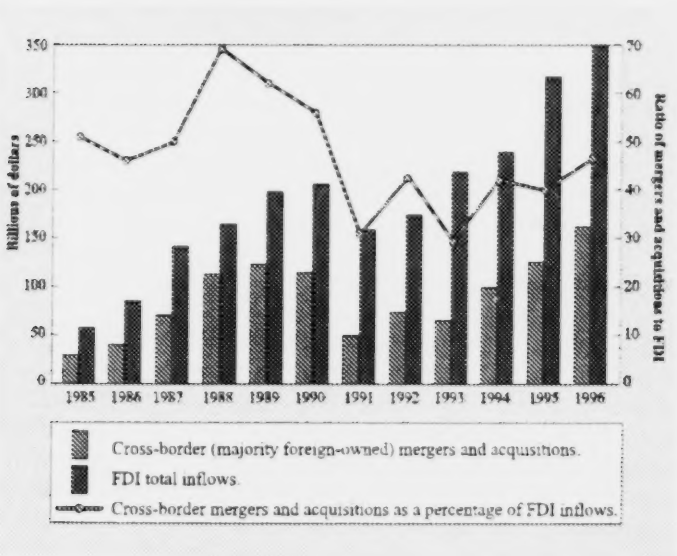
Complementing the increases in M&As and FDI flows, the number of cross-border inter-firm agreements (equity and non-equity, other than strategic research-and-development (R&D) partnerships) has also increased. In 1995, nearly 4,600 such agreements were concluded, compared with about 1,760 in 1990. These agreements take place primarily between firms based in developed countries: United States firms participated in 80 per cent of them, European Union firms in 40 per cent and Japanese firms in 38 per cent. Recently, firms based in developing countries have also begun to conclude such agreements actively. The number of cross-border inter-firm agreements (other than strategic R&D partnerships) with developing-country firm participation has increased in absolute numbers, as well as a share of the world total

(from 27 per cent during 1990-1992 to 35 per cent during 1993-1995). Although there was a decline in 1995, the number of strategic R&D partnerships (in core technologies, such as information technologies and biotechnology), has also been rising steadily since 1990. Again, developing-country firms a. sumed a bigger role in strategic partnerships (3 per cent in 1989 to 13 per cent in 1995), suggesting that these firms may have attained sufficient technological sophistication and capacity to make them worth having as partners.

... and with an increasing transnationalization of the largest TNCs based in both developed and developing countries.

Despite the growing number of small and medium-sized enterprises with investments abroad, a good part of FDI continues to

Figure 3. Relationship between cross-border mergers and acquisitions and FDI, 1985-1996
(Billions of dollars and percentage)



Source: UNCTAD, *World Investment Report 1997*, p. 9.

be concentrated in the hands of a small number of companies. The largest 100 TNCs (table 3), ranked on the basis of the size of foreign assets, own $1.7 trillion assets in their foreign affiliates, controlling an estimated one-fifth of global foreign assets. In the United States, 25 TNCs are responsible for half of that country's outward stock, a share that has remained almost unchanged during the past four decades. For six out of nine developed countries for which such data are available, 25 TNCs account for more than a half of their respective countries' outward stocks (table 4).

For the first time, two developing-country TNCs, Daewoo Corporation (Republic of Korea) and Petroleos de Venezuela S.A. (Venezuela), have entered the list of the top 100 TNCs. Daewoo Corporation also tops the list of the 50 largest TNCs based in developing countries (table 5) for the second year running, while Royal Dutch Shell (United Kingdom/Netherlands) continues to top the list of the largest 100 TNCs for the fifth consecutive year. With foreign sales amounting to $2 trillion and foreign employment close to 6 million persons in 1995, the largest 100 TNCs are prominent actors in international production. The top 50 TNCs based in developing countries, however, are catching up. While their foreign assets totalled only $79 billion in 1995, the increase in these assets between 1993 and 1995 was 280 per cent — compared with 30 per cent for the top 100 firms.

Both the top 100 TNCs worldwide and the top 50 developing-country TNCs are becoming more transnationalized, at a faster rate in the latter case. The food firms in the list of the top 50 developing-country TNCs exhibited the biggest increase in transnationality (measured on the basis of a combined index of the ratios of foreign assets, foreign sales and foreign employment in their respective totals) — from 16 per cent in 1993 to 37 per cent in 1995. On the whole, smaller firms tend to be more transnationalized than larger ones; for example, Solvay SA (Belgium) ranked seventy-fourth on the basis of the size of foreign assets, but ranked fifth on the basis of the transnationality index in the list of the top 100 TNCs. And Panamerican Beverages Inc. (Mexico) took the first place in the list of the top 50 developing-country firms on the basis of the transnationality index, as opposed to twenty-first on the basis of the value of foreign assets.

Table 3. The top 25 TNCs ranked by foreign assets, 1995

(Billions of dollars and number of employees)

Ranking by: Foreign assets	Index [a]	Corporation	Economy	Industry [b]	Assets		Sales		Employment		Index [a]
					Foreign	Total	Foreign	Total	Foreign	Total	
1	17	Shell, Royal Dutch [c]	United Kingdom/ Netherlands	Oil, gas, coal and rel. services	79.7	1176	80.6	109.9	81000	104000	73.0
2	83	Ford Motor Company	United States	Automotive	69.2	238.5	41.9	137.1	103334 [d]	346990	29.8
3	87	General Electric Company	United States	Electronics	69.2	228.0	17.1	70.0	72000	222000	29.1
4	22	Exxon Corporation	United States	Oil, gas, coal and rel. services	66.7	91.3	96.9	121.8	44000	82000	68.8
5	86	General Motors	United States	Automotive	54.1	217.1	47.8	163.9	252699	745000	29.3
6	27	Volkswagen AG	Germany	Automotive	49.8	58.7	37.4	61.5	114000	257000	63.4
7	43	IBM	United States	Computers	41.7	80.3	45.1	71.9	112944	225347	54.9
8	78	Toyota Motor Corporation	Japan	Automotive	36.0	118.2	50.4	111.7	33796	146855	32.9
9	1	Nestlé SA	Switzerland	Food	33.2	38.2	47.8	48.7	213637	220172	94.0
10	71	Mitsubishi Corporation	Japan	Diversified	[e]	79.3	51.0	124.9	3859	9241	39.5
11	18	Bayer AG	Germany	Chemicals	28.1	31.3	19.7	31.1	78000	142900	69.3
12	6	ABB Asea Brown Boveri Ltd.	Switzerland	Electrical equipment	27.2	32.1	29.4	33.7	196937	209637	88.6
13	66	Nissan Motor Co., Ltd.	Japan	Automotive	26.9	63.0	24.9	56.3	60795 [d]	139856	43.5
14	40	Elf Aquitaine SA	France	Oil, gas, coal and rel. services	26.9	49.4	27.8	42.5	40650	85500	55.8
15	32	Mobil Corporation	United States	Oil, gas, coal and rel. services	26.0	42.1	48.4	73.4	26300	50400	60.0

(Table 3, cont'd)

Ranking by: Foreign assets	Index [a]	Corporation	Economy	Industry [b]	Assets		Sales		Employment		Index [a]
					Foreign	Total	Foreign	Total	Foreign	Total	
16	70	Daimler-Benz AG	Germany	Automotive	26.0	66.3	45.6	72.1	68907	310993	41.5
17	8	Unilever [f]	United Kingdom/ Netherlands	Food	25.8	30.1	42.7	49.7	276000	307000	87.1
18	9	Philips Electronics N.V.	Netherlands	Electronics	25.2	32.7	38.4	40.1	221000	265100	85.4
19	10	Roche Holding AG	Switzerland	Pharmaceuticals	24.5	30.9	12.0	12.5	40422	50497	85.1
20	54	Fiat Spa	Italy	Automotive	24.4	59.1	26.3	40.6	95930	248180	48.2
21	59	Siemens AG	Germany	Electronics	24.0	57.7	35.5	62.0	162000	373000	47.4
22	33	Sony Corporation	Japan	Electronics	[d]	47.6	30.3	43.3	90000	151000	59.1
23	30	Alcatel Alsthom	France	Electronics	22.7	51.2	24.2	32.1	117400	191830	60.3
24	53	Hoechst	Germany	Chemicals	21.9	36.7	13.4	36.3	100035 [e]	161618	48.3
25	68	Renault SA	France	Automotive	21.2	44.6	19.1	36.8	40066	139950	42.7

Source: UNCTAD, *World Investment Report 1997*, p. 29.

a The index of transnationality is calculated as the average of ratios of foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

b Industry classification for companies follows the United States Standard Industrial Classification as used by the United States Security Exchange Commision (SEC).

c Foreign sales are outside Europe whereas foreign employment figures are outside United Kingdom and the Netherlands.

d Data on foreign assets are either suppressed to avoid disclosure or they are not available. In case of non-availability, they are estimated on the basis of the ratio of foreign to total sales, foreign to total employment and similar ratios for the transnationality index.

e Data on foreign employment are either suppressed to avoid disclosure or or they are not available. In case of non-availability, they are estimated on the basis the ratio of foreign to total sales, foreign to total assets and similar ratios for the transnationality index.

f Foreign assets, sales and employment figures are outside the United Kingdom and the Netherlands.

g Foreign assets, sales and employment figures are outside the United Kingdom and Australia.

Table 4. The share of top TNCs in outward FDI stock, selected countries, 1995
(Percentage)

Country	Top 5	Top 10	Top 15	Top 25	Top 50
Australia [a]	45.0	57.0	66.0	80.0	96.0
Austria	10.0	17.3	22.2	30.5	44.0
Canada	22.6	33.5	40.1	50.1	64.4
Finland	33.0	47.0	56.0	69.0	84.0
France	14.0	23.0	31.0	42.0	59.0
Germany	17.5	29.3	35.0	41.8	51.5
Norway	63.8	75.2	81.1	86.8	92.9
Sweden	23.0	37.0	48.0	59.0	76.0
United Kingdom	28.0	40.0	47.0	57.0	71.0
United States [b]	19.0	33.0	42.0	51.0	63.0

Source: UNCTAD, *World Investment Report 1997*, p. 34.

[a] 1996.

[b] Preliminary estimate on the basis of 1994 data and foreign-affiliate assets.

The Triad (European Union, United States and Japan) is home to 87 per cent of the top 100 TNCs and accounts for 88 per cent of their foreign assets. Likewise, China, the Republic of Korea, the Hong Kong Special Administrative Region of the People's Republic of China (hereinafter: Hong Kong, China) and Mexico are home to 56 per cent of the top 50 firms based in developing economies, and account for two-thirds of their foreign assets. Electronics is the most important industry as far as the largest TNCs are concerned, accounting for some 16 per cent of all firms' foreign assets in each of the two lists of top TNCs. Automotive and chemical firms also feature prominently in both lists, but more so in the list of the top 100 firms. Petroleum and mining firms, although few in number, tend to rank high in both lists.

The growth of international production has been facilitated by ongoing liberalization ...

The expansion of international production would not have been possible if it were not for the ongoing liberalization of FDI regimes. The trend towards greater liberalization was sustained again in 1996,

Table 5. The top 25 TNCs based in developing economies ranked by foreign assets, 1995

(Millions of dollars and number of employees)

Ranking by: Foreign assets	Index [a]	Corporation	Economy	Industry [b]	Assets		Sales		Employment		Index [a]
					Foreign	Total	Foreign	Total	Foreign	Total	
1	9	Daewoo Corporation [c]	Republic of Korea	Diversified/trading	11946.0	28898.0	8202.0	26044.0	28140	38920	48.4
2	12	Petroleos de Venezuela SA	Venezuela	Oil, gas, coal and rel. services	6796.0	40502.0	24488.0	26041.0	13420	60007	44.4
3	8	Cemex SA	Mexico	Construction	4226.7	8407.9	1435.2	2575.8	7300	17212	49.5
4	2	First Pacific Company Ltd.	Hong Kong	Electronics Parts	3779.2	6821.2	4694.3	5249.7	33467	45911	72.6
5	13	LG Electronics, Ltd.	Republic of Korea [d]	Electronics	[e]	15084.8	7100.0	12199.9	14113	34961	40.4
6	7	Jardine Matheson Holdings Ltd.	Bermuda	Diversified	3092.6	11582.7	7417.3	10636.0	140000 [e]	200000	55.5
7	14	Hutchison Whampoa Limited	Hong Kong	Diversified/retailer	2900.0[e]	11699.0	1632.2	4531.0	16115	29137	38.7
8	23	YPF Sociedad Anonima	Argentina	Oil, gas, coal and rel. services	2551.0	11572.0	1960.0	4970.0	2275	9256	28.7
9	44	China State Construction Engineering Corp.	China	Diversified/ construction	2379.4	[b]	1103.9	[b]	[b]	[b]	0.0
10	35	Sunkyong Group	Republic of Korea	Energy/trading/ chemicals	2258.0	27729.0	8635.0	36085.0	2083	25298	13.4
11	17	Cathay Pacific Airways Limited	Hong Kong	Transportation	2133.0	6267.0	1898.0	3904.0	3877	14744	36.3
12	34	Samsung Electronics Co., Ltd.	Republic of Korea[d]	Electronics	[e]	21894.6	4807.7 [e]	24083.2	9177 [e]	71440	14.2
13	45	China Chemicals, Imp. & Exp., Corp.	China	Diversified/trading	2016.5[b]	8317.6	[b]	[b]	[b]	[b]	0.0
14	42	Petroleo Brasileiro S/A - Petrobas	Brazil	Oil, gas, coal and rel. services	1881.5	31699.8	1274.0	23456.5	23	46226	3.8
15	32	Singapore Telecom-munications Ltd.	Singapore	Utilities	1546.2	5661.7	66.2	2840.2	1625	10966	14.8
16	40	Hyundai Corporation	Republic of Korea[d]	Diversified/ machinery	1485.2	11480.0	2432.7	15130.7	923	44736	10.4
17	38	Companhia Vale Do Rio Doce	Brazil	Mining	1471.0	14564.0	1407.0	5214.0	90	15573	12.6

(Table 5, cont'd)

Ranking by: Foreign assets	Index [a]	Corporation	Economy	Industry [b]	Assets		Sales		Employment		Index [a]
					Foreign	Total	Foreign	Total	Foreign	Total	
18	19	Grupo Televisa S.A. De C.V.	Mexico	Media	1385.0	3215.0	280.0	1149.0	6981 [e]	20700	33.7
19	18	New World Development Co. Limited	Hong Kong	Diversified/ construction	1160.7	12395.6	470.9	2159.3	33550	45000	35.2
20	11	Citic Pacific Ltd.	Hong Kong	Diversified/trading/ automotive	1069.6	5093.5	693.7	1401.1	7900	11500	46.4
21	1	Panamerican Beverages Inc.	Mexico	Beverages	1003.6	1372.1	1236.3	1608.3	21001 [e]	28000	75.0
22	3	Gruma S.A. De C.V.	Mexico	Food	992.5	1095.5	537.7	995.1	9834 [e]	13598	72.3
23	10	Dairy Farm International Holdings Ltd.	Hong Kong	Retailing	965.8	2934.8	3979.5	6235.5	24956	51600	48.4
24	36	Companhia Cervejaria Brahma	Brazil	Beverages	962.8	3310.2	173.2	2304.7	541.0	8467.0	
25	6	Fraser & Neave Limited	Singapore	Beverages	957.0	3199.0	1066.0	1809.0	8190	10064	56.7

Source: UNCTAD, *World Investment Report 1997*, p. 32.

[a] The index of transnationality is calculated as the average of ratios of foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

[b] Industry classification for companies follows the United States Standard Industrial Classification which is used by the United States Stock Exchange Commission (SEC).

[c] Consolidated data are provided which include data for Daewoo Electronics and Daewoo Heavy Industries, amongst others.

[d] The accounting standards of the Republic of Korea do not require the publication of consolidated financial statements including for both domestic and foreign affiliates. The figures here are estimates of consolidated financial statements as provided by the companies in response to a survey by UNCTAD.

[e] Data on foreign assets are either suppressed to avoid disclosure or they are not available. In case of non availability, they are estimated on the basis of the ratio of foreign to total sales, foreign to total employment and similar ratios for the transnationality index.

[f] Data on foreign sales are either suppressed to avoid disclosure or or they are not available. In case of non-availability, they are estimated on the basis of the ratio of foreign to total assets, foreign to total employment and similar ratios for the transnationality index.

[g] Data on foreign employment are either suppressed to avoid disclosure or they are not available. In case of non-availability, they are estimated on the basis of the ratio of foreign to total sales, foreign to total assets and similar ratios for the transnationality index.

with 98 changes in the direction of investment liberalization and promotion of a total number of 114 changes in investment regimes introduced during that year in 65 countries (table 6). Over the period 1991-1996, indeed, some 95 per cent of a total of 599 changes in the regulatory FDI regimes of countries were in the direction of liberalization. They mostly involved the opening of industries previously closed to FDI, the streamlining or abolition of approval procedures and the provision of incentives (figure 4).

The desire of governments to facilitate FDI is also reflected in the dramatic increase in the number of bilateral investment treaties (BITs) for the protection and promotion of investment throughout the 1990s. As of 1 January 1997, there were 1,330 such treaties in the world, involving 162 countries, a threefold increase in half a decade. Around 180 such treaties were concluded in 1996 alone -- one every second day.

The pattern of these treaties has changed considerably in recent years. While virtually all BITs used to have one developed country as a partner, and such countries took part in 83 per cent of all such treaties as of the end of the 1980s, by 1996 only 62 per cent of the world total involved developed countries. Indeed, countries in Central and Eastern Europe and developing countries have begun to conclude BITs among themselves. At the beginning of 1997, 16 per cent of all

Table 6. Regulatory changes, 1991-1996

(Number)

Item	1991	1992	1993	1994	1995	1996
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65
Number of regimes	82	79	102	110	112	114
Of which:						
In the direction of liberalization or promoting [a]	80	79	101	108	106	98
In the direction of control [b]	2	-	1	2	6	16

Source: UNCTAD, *World Investment Report 1997*, p. 18.

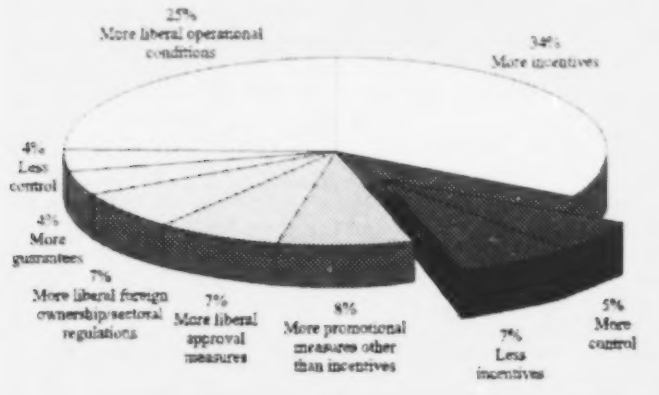
[a] Including measures aimed at strengthening market supervision, as well as incentives.

[b] Including measures aimed at reducing incentives.

BITs were among developing countries, rising from 11 per cent at the end of the 1980s. In 1996 alone, nearly a third of all BITs were concluded between developing countries, led by China, Chile, Algeria and the Republic of Korea.

New ground is being broken at the regional and multilateral levels. Negotiations on an investment framework are taking place in the Organisation for Economic Co-operation and Development, with the conclusion of a free-standing Multilateral Agreement on Investment rescheduled for May 1998. In the framework of the discussions on a possible Free Trade Area of the Americas, a Working Group on Investment has been established, as well as a Working Group on Competition Policy. In the meantime, the Ministerial Meeting of the World Trade Organization in Singapore in December 1996 established two working groups to examine the relationship between trade and investment and between trade and competition policy. Independently of these developments, the ASEAN members are preparing to launch the ASEAN Investment Area. Cooperation

Figure 4. Types of changes in FDI laws and regulations, 1996[a]



Source: UNCTAD, *World Investment Report 1997*, p. 19.

[a] There were 138 changes in 114 measures that were implemented in 65 countries.

among ASEAN members in the area of investment has already progressed with the signing of a protocol (in September 1996) updating the 1987 ASEAN Agreement for the Promotion and Protection of Investment.

... and holds good prospects for being sustained into the next century.

The ongoing globalization of production begs the question of whether the upward trend in FDI flows witnessed to date will continue into the next century. A survey of foreign investors suggests that this may, indeed, be the case. More specifically, foreign sales are expected to increase as a proportion of total sales, especially for Japanese and United States' firms. Production by foreign affiliates is also expected to increase as a proportion of total production by TNCs, while home-country exports are expected to remain constant. Mergers and acquisitions, joint ventures and other equity and non-equity types of inter-firm agreements are expected to go hand in hand with the growth in FDI. Although smaller firms will be stepping up investments abroad, large firms will continue to account for the lion's share of outward investments. Corporate restructuring in developed countries, aimed at improving efficiency and modernization, is expected to continue, giving rise to efficiency-seeking investment. However, accessing markets will remain the principal motive for investing abroad: survey respondents placed twice as much weight on production for local markets than on labour-cost factors. Countries in developing Asia and, to a lesser extent, in Latin America and Central and Eastern Europe, are likely to be the main beneficiaries of the corporate restructuring. Investment at home generally will be given a lower priority than it has received until now. In contrast, investment in the same region will continue to be significant, while investment in more distant countries is likely to increase, thus broadening the geographical scope of international production. Foreign investors foresee dramatic increases in investments in infrastructure, distribution, non-financial services and automobiles, but slower growth in financial services and real estate. All in all, the growth of FDI is expected to remain brisk over the next five years, both in terms of absolute levels and as a proportion of corporate investment.

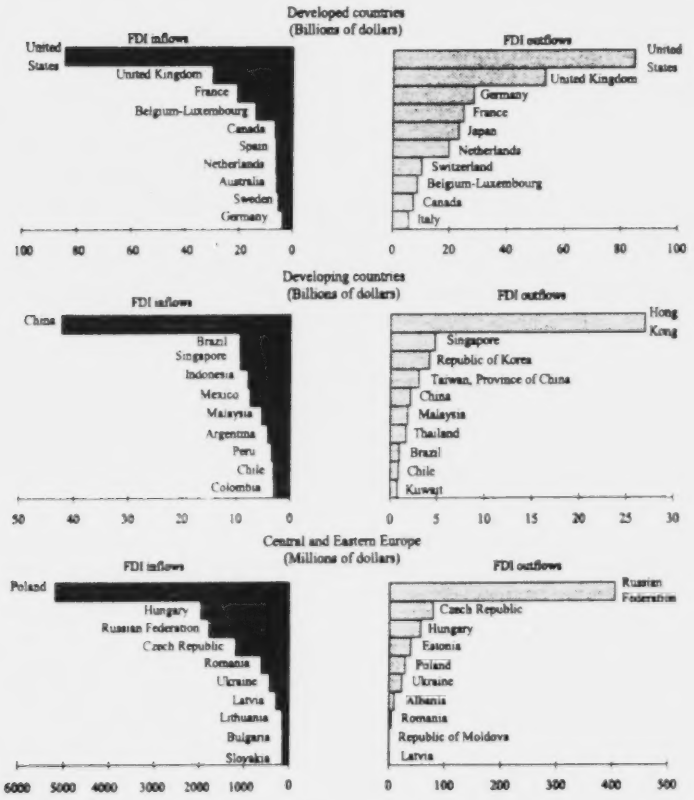
The United States is by far the largest FDI recipient and investor abroad,...

Developed countries' investments abroad reached an all-time high of $295 billion in 1996. The investment picture for developed countries is dominated by the United States, which, with $85 billion is by far the largest home country (by a margin of $31 billion over the United Kingdom, the second largest home country), as well as, with $85 billion, the largest recipient country (by a margin of $42 billion over China, the second largest recipient) in 1996 (figure 5). Around two-fifths of United States outflows go to the European Union and around 30 per cent to developing countries. Growing consumer markets have encouraged United States investments in the latter, while sluggish growth in the former has led to a decrease in its share of United States outflows. Investment flows into the United States — mostly in the form of M&As — were stimulated by its strong and sustained growth performance and potential for high profits.

Western Europe received $105 billion in inflows and invested $176 billion abroad in 1996. More European Union investment is now directed to non-European Union countries than in 1992, when the internal market was completed. These countries are investing increasingly outside Western Europe, mostly in North America, developing Asia and, to a lesser extent, Central and Eastern Europe. Nearly a half of the European Union's investment outflows take the form of M&As. The share of European Union inflows accounted for by M&As, however, is considerably smaller because of regulatory and other barriers in existence in some countries (such as Italy and Germany) on this mode of investment. Japanese investment in the European Union is declining — to almost $2 billion in 1994, compared with nearly $7 billion at its peak in 1990.

Overall, however, the recovery of Japan's outward investment continues, with outflows reaching $23 billion in 1996, slightly over half their peak level of $41 billion during 1989-1991. (It should be noted that reinvested earnings, estimated at $14 billion in the manufacturing sector alone in 1994, are not included in these figures.) Japanese outflows are geared overwhelmingly towards developing Asia and the United States. But in Asia, China is no longer the favourite

Figure 5. Top ten largest host and home countries for FDI, among developed countries, developing countries and Central and Eastern Europe, 1996



Source: UNCTAD, *World Investment Report 1997*, p. 5.

location and, in fact, its share of Japanese outflows declined in 1996. Brazil is beginning to receive Japanese investment, with Japanese outflows there (on the basis of notifications) tripling in 1996 over 1995. On the inward side, Japan remains a small FDI recipient, with inflows declining to $220 million in 1996.

... but developed countries are becoming, on the whole, less important hosts.

Although developed countries received a record $208 billion in FDI flows in 1996, there has been a steady decline in their share of global inflows since 1989. That decline can be attributed partly to the increasing attractiveness of developing countries, especially those that are growing rapidly and have large domestic markets. Furthermore, some developed countries that are large outward investors are small investment recipients, especially in relation to the size of their economies; notable examples are Germany, Italy and Japan. And as the rationalization of production through FDI in response to regional integration arrangements among developed countries (notably, the European Union) has reached a high level, firms are turning increasingly towards untapped markets found mostly in the developing world.

Developing countries — even some of the least developed ones — enjoy rapidly growing investments, ...

In light of the above, it is not surprising that developing countries received $129 billion of FDI inflows in 1996 and invested $51 billion abroad — both amounts are all-time highs. Their share of world inflows rose to 37 per cent in 1996 (from 30 per cent in 1995), while their share of outflows was 15 per cent in that year. With $42 billion, China was the largest developing-country recipient (figure 5); the country's success can be attributed mostly to its large and growing domestic market, "soft landing" and macroeconomic reforms, as well as to measures to promote investment in provinces other than those in the coastal areas.

Every developing region saw an increase in inflows. Even the 48 least developed countries experienced an increase in inflows of

56 per cent in 1996, to $1.6 billion. Cambodia was the largest recipient in this group of countries. In addition, and despite the small size of inflows (both in absolute values and as a share of all developing-country inflows), FDI is very important for many of these economies; inflows in as many as eight countries reached 10 per cent as a share of gross fixed capital formation in 1995.

Within the group of the least developed countries, there are significant disparities in performance as regards FDI. The Asian least developed countries are benefiting from the Asian industrializing economies' process of industrial restructuring in the framework of the "flying-geese" model, not only because they offer complementary locational advantages in the form of low-cost labour, but also because of their geographical proximity to them. More than four-fifths and nearly two-fifths, respectively, of cumulative investments received by Bangladesh and Myanmar over the period 1990-1994, for example, came from developing Asia. Since a similar "in-tandem" restructuring process is not taking place in Africa, the least developed countries in that continent do not have the same opportunity to benefit from the type of intra-regional FDI inflows that is the outcome of this process in Asia.

... with new record levels in South, East and South-East Asia, ...

With $81 billion in inflows in 1996, South, East and South-East Asia received about two-thirds of the developing-country total in that year. The 25 per cent increase in these inflows over 1995 was also in sharp contrast with the large decline in the rate of growth of exports and, to a lesser extent, of the gross domestic product, in that year. China accounted for over two-fifths of the $16 billion increase in investment inflows in the region.

Next to China, Singapore was the second largest investment recipient, with inflows worth $9 billion, exceeding the combined inflows of the other newly industrializing economies (Hong Kong, China, Republic of Korea and Taiwan Province of China). Flows into Hong Kong, China, were $2.5 billion in 1996. Foreign-investor confidence in Hong Kong, China, after its reversion to China on 1 July 1997 is strong, as indicated by a number of surveys of foreign

(and local) companies. Indonesia, Malaysia, Philippines and Thailand together received some $17 billion in 1996, an increase of 43 per cent over 1995. Together, ASEAN members have, however, seen their share of the region's investment inflows decline, from 61 per cent during 1990-1991 to below 30 per cent during 1994-1996, attributed to domestic capacity constraints, infrastructure bottlenecks and, in particular, stiff competition from other economies. A 34 per cent increase in investment flows to India (to $2.5 billion) pushed total inflows to South Asia to $3.5 billion. Investment from other Asian economies in India, especially from the Republic of Korea, are outstripping those of some developed countries, such as the United States and the United Kingdom.

South, East and South-East Asia are emerging as important outward sources of FDI. Indeed, the region is the largest source of FDI in the developing world, with outflows increasing by 10 per cent in 1996, to $46 billion. Hong Kong, China is the single largest outward investor ($27 billion in 1996). Recently, the geographical scope of developing Asia's outward FDI has expanded to include non-traditional destinations, such as the European Union, Central and Eastern Europe and Africa. The extent to which Asian developing economies are transnationalized is reflected in the increasing ratios of investment outflows to gross fixed capital formation for the region as a whole, as well as for individual economies. That ratio, for example, is higher for Singapore (14 per cent) and Malaysia (11 per cent) than for Western Europe (10 per cent) and the United States (9 per cent).

... as well as Latin America and the Caribbean, ...

Investment flows into Latin America and the Caribbean increased by 52 per cent in 1996, the highest increase of any developing region, to a record level of nearly $39 billion. Far-reaching changes in the region's FDI regimes — both at the national level and through the conclusion of bilateral investment treaties — have certainly contributed to this performance. Even during the turbulence in portfolio investment flows into that region in 1994 and 1995, FDI flows registered small but steady increases. Latin America and the Caribbean now account for 30 per cent of all developing country

inflows. Investment inflows into Argentina tripled in 1996 to $4.3 billion, propelled by the country's membership in MERCOSUR (which contributed particularly to automobile investments), the liberalization of mining legislation and privatization schemes. But the most noteworthy performance has been that of Brazil. With nearly $10 billion, Brazil has surpassed Mexico (with around $8 billion) as the star performer in Latin America in 1996. (In the first four months of 1997, inflows were over $4 billion — two and a half times higher than inflows in the same period in 1996.) This represents a dramatic reversal: in 1992, with $2 billion, Brazil ranked third in the region (after both Mexico and Argentina). The upswing in Brazil's inflows is the outcome of large investments in automobiles (in the context of intra-regional production rationalization triggered by MERCOSUR) and the reactivation of its privatization programme. Foreign-investor confidence in Brazil (and in the region as a whole) is high: in a recent survey, company executives expressed more confidence in Latin America's prospects now than five years ago, placing Brazil, Mexico and Chile in top places.

The United States remains the foremost foreign investor in the region, with firms investing now more heavily in Brazil than in any other country there. Canada's investment in Latin America and the Caribbean is also sizeable, but concentrated mostly in mining and exploration. Western Europe's investment in Latin America and the Caribbean (largely from Germany and Spain) is on the rise, and is mostly directed towards Brazil, Argentina and Mexico (in natural resources and services). Almost a half of Western Europe's investment into that region has come through privatization schemes, but in 1995 and 1996 greenfield investment has also been prevalent in automobile manufacturing. Japanese investment in Latin America remains small and highly concentrated in tax havens in the Caribbean. Intra-regional investment has increased substantially, with Chile, Brazil and Argentina being the principal source countries, and Argentina, Peru and Venezuela the principal destinations. Developing Asian countries continue to invest in export-related industries, although market-seeking investments spurred by the region's recent integration efforts are also on the rise.

... with signs of revival of FDI flows to Africa ...

Africa continues to receive small levels of investment flows (nearly $5 billion in 1996), an increase of only 5 per cent, the smallest of any developing region. On average, Africa's share of developing-country inflows has more than halved between 1986-1990 and 1991-1996 — to 5 per cent in the latter period. Political unrest, armed conflict, low domestic investment levels and frequent changes in economic policies that affect business calculations of expected risks and returns have contributed to this relative decline.

However, Africa's investment performance looks less gloomy when put into perspective. In relation to the size of a number of economies, those investments can be fairly significant. For the region as a whole, the ratio of investment inflows to gross fixed capital formation was 5.4 per cent, compared with 5.5 per cent for Asia and 5.9 per cent for Western Europe during the first half of the 1990s. Putting the size of Africa's FDI stock in relation to the size of Africa's domestic market (GDP) yields a share of 10 per cent — compared with 14 per cent for Asia, 18 per cent for Latin America and the Caribbean and 13 per cent for Western Europe in 1995. While these figures suggest that the significance of the investment that Africa receives (without the benefit of large intra-regional investment) is certainly not negligible, they do not say anything about Africa's need for investment nor, for that matter, the continent's potential.

Prospects for increased flows to some parts of Africa are encouraging. Favourable growth performances, further investment and trade liberalization and privatization, regional cooperation agreements and the establishment of links with other regions are all likely to increase the region's attractiveness. In addition, South Africa could begin to play a significant role as a "growth pole", contributing to the region's economic development through FDI and trade. As regards the former, South Africa's contribution could be through the provision of investment capital, adding to capital formation in the recipient economies; the transfer of technology; the development of local human resources; and the opening up of its own market to the exports of foreign affiliates that have invested in neighbouring economies. Indeed, the question has arisen whether South African

firms can induce the development of new industries, especially in manufacturing, in its neighbours by establishing an intra-regional division of labour in the framework of which production at home is upgraded to capital- and technology-intensive activities. In this "flying geese" process of industrial restructuring and upgrading, South Africa would play the lead role, similar to the role played by Japan in the context of Asia's development. At this point in time, however, it appears that the necessary conditions for this type of intra-regional restructuring to occur are still far from being met, including — to stay within the metaphor — because many of South Africa's neighbours are still in the "nest-building" stage.

... and of growing non-oil investments in West Asia, ...

After large disinvestments in West Asia in 1995 that resulted in negative inflows, particularly in Saudi Arabia and Yemen, inflows attained a level of nearly $2 billion in 1996. Excluding these two countries, investment flows into West Asia show a much more stable trend. In fact, the volatility of inflows to these two countries — albeit important ones — masks considerable improvements in the investment performance of other countries in the region in response to successful efforts to create business-friendly environments.

Over time, the share of West Asia in total developing country investment inflows has been declining — from 30 per cent during the first half of the 1980s to only 2 per cent during the first half of the 1990s. That shift reflects largely decreasing investment flows to oil producing economies (Saudi Arabia, Oman, Qatar and United Arab Emirates). While petroleum naturally remains the most popular industry in these economies, in the non-oil producing countries (Jordan, Lebanon and Turkey) investments go mainly to manufacturing and services.

... while a slow-down in privatization contributed to a decline in FDI flows to Central and Eastern Europe.

In 1996, FDI flows to Central and Eastern Europe experienced a decline — to $12 billion from $14 billion in 1995, partly reflecting declines in privatization-related investments in Hungary and the

Czech Republic. As long as investment flows to that region depend to a large extent on the participation of foreign investors in privatization programmes, a certain degree of "lumpiness" — year-to-year volatility — is to be expected. The decline might also stem from other problems related to the transition to a market economy. Foreign investors, for example, might have overestimated the region's ability to absorb investments and might have temporarily shelved their plans for expansion. However, despite the decline, flows in 1996 were still more than twice as high as the annual average during 1992-1994. The estimated FDI stock in Central and Eastern Europe was $46 billion in 1996 — almost comparable to the 1996 investment flows to China ($42 billion).

Investment flows to Central and Eastern Europe remain concentrated in the Czech Republic, Hungary and Poland, together accounting for some two-thirds of the region's inflows (figure 5). Transnational corporations from Western Europe dominate the investment picture, followed by corporations from the United States and, more recently, the Asian newly industrializing economies. A small but growing share of inflows is attributed to corporations based in Central and Eastern Europe itself. This is also reflected in the fact that 16 per cent of the BITs concluded by Central and Eastern European countries has been with other countries in the same region.

Accompanying the FDI boom, foreign portfolio equity investment in developing countries has also accelerated, ...

Substantial flows of foreign portfolio equity investment to emerging markets is a recent phenomenon dating only from the early 1990s. The year 1993 was the watershed for such flows when their level trebled, to $45 billion, from the previous year. However, the level of these flows fell in the two subsequent years in response to the Mexican peso crisis — by 27 per cent and 2 per cent in 1994 and 1995, respectively — but recovered in 1996. The volume of new equity raised on international capital markets by emerging markets in that year increased by 34 per cent, reaching some $15 billion.

In principle, foreign portfolio equity investment and direct investment are quite distinct. By definition, foreign portfolio equity investment is distinguished from FDI by the degree of management

control that foreign investors exercise in a company. Portfolio equity investors usually provide only financial capital without any involvement in a company's management, and typically have a shorter-term investment horizon than direct investors. The latter have a significant and long-lasting management interest in the company in which an investment is made. In general, the dividing line between the two types of investment is the threshold of a 10 per cent equity stake. In practice, however, the distinction between the two categories of investment is often less clear-cut and is subject to a number of qualifications.

The overriding motivation for investment by portfolio equity investors is their participation in earnings of local enterprises through capital gains and dividends. Transnational corporations tend to be more interested in accessing markets and resources and, more generally, in the contribution that an investment can make to the competitiveness of the transnational corporate system as a whole. The contrast in motives between TNCs and portfolio equity investors is not, however, always so stark. In the notable case of venture capital investment, the investment horizon tends to be somewhat longer than for foreign portfolio equity investment, and the existence of significant (and perhaps also long-term) management control is not unusual, although the foremost motivation is to share in the capital gains of the equity of a local enterprise when it is listed eventually on the stock exchange.

... encouraged by the liberalization and globalization of financial markets and the growth of funds in the hands of institutional investors.

Two major factors lie behind the rise in foreign portfolio equity investment flows into emerging markets: the liberalization and globalization of financial markets and the concentration of substantial financial resources in the hands of institutional investors. Investments into emerging markets have been facilitated by the rapid provision of market information made possible by improvements in communications technology and the willingness of portfolio equity investors to bear greater risks in the expectation of reaping higher returns in these new and fast-growing markets. The higher returns

have been made possible by the sustained superior growth performance of emerging markets in comparison to that of developed economies during the 1990s. Stock market capitalization in emerging markets has also grown much faster than that in developed countries. However, as in the case of FDI flows, portfolio equity investment flows have remained skewed towards a small group of mostly upper middle-income emerging markets, along with two large low-income countries with impressive growth performances and prospects. (Asia alone accounted for 53 per cent of net foreign portfolio equity investment flows to emerging markets in 1995.) This is not surprising. For many large institutional investors, it is more attractive to invest in more mature emerging markets that tend to have a relatively large market capitalization and provide high liquidity levels, relatively fast and reliable settlement systems and a generally more developed market infrastructure.

There is also a certain level of concentration when it comes to the origin of foreign portfolio equity investment flows. Over the period 1992-1994, it is estimated that more than 35 per cent of flows to emerging markets originated in the United States, 15 per cent in Japan and 11 per cent in the United Kingdom. In recent years, investors from Hong Kong and Singapore have also invested in emerging markets. For the United States, the most important source country, investment flows to emerging markets have followed the global trend, increasing substantially in 1993, decreasing in 1994 and 1995, and rising again in 1996, despite a clear upturn in stock-market returns in the United States.

In light of the vastly increased volume of foreign portfolio equity investment flows to emerging markets, the impact of these flows on host-country economies is likely to be significant. Although such investments can make an important contribution to the financing of equity capital of local companies, concerns have been expressed by host countries particularly as regards the volatility of these flows and their effect on exchange rates. In order to address this issue, it is necessary to investigate the causes of that volatility and the availability of measures or mechanisms to reduce or withstand it.

FOREIGN DIRECT INVESTMENT, MARKET STRUCTURE AND COMPETITION POLICY

As countries liberalize their FDI policies, it becomes important to ensure the efficient functioning of markets ...

As countries liberalize their FDI regimes and firms increase their investment activities across national borders, maintaining the proper functioning of markets assumes increasing importance. Freer flows of FDI mean a greater reliance on market forces to determine the volume and distribution of FDI and its economic impact. Countries, especially developing countries that are liberalizing rapidly, are therefore interested in ensuring that the reduction of regulatory barriers to FDI and the institution of standards of treatment are not accompanied by the emergence of private barriers to entry and anti-competitive behaviour of firms. Competition and competition policy in relation to FDI need, therefore, to be better understood. Part Two of *WIR 97* focuses on the relationships between FDI, market structure and competition, and considers policy implications arising from these relationships, especially as they concern developing countries. The discussion of these issues rounds out, therefore, discussions in previous *Reports*, of FDI liberalization and related regulatory frameworks, including those relating to international investment arrangements.

The ultimate objective of FDI liberalization is to enhance economic growth and welfare in countries. Success in this respect depends not only on increasing FDI flows — and the capital, technology, managerial know-how and market access associated with them — but also on ensuring that the industries and markets in which TNCs participate operate efficiently. In market-based economies, the efficient functioning of markets depends on the contestability of markets — or the ease with which firms can enter and exit them — and the extent and nature of competition in markets. Foreign-direct-investment liberalization, by removing formal barriers to the entry of FDI, can increase the contestability of national markets and inject greater competition into them. However, because of the ownership-specific assets of TNCs, their transnational organizational structures and the relatively greater competitive strengths that they

often have vis-à-vis domestic firms, FDI could also increase concentration, and TNCs could indulge, like dominant firms generally, in restrictive and anticompetitive practices. Government policy and practices aimed at attracting investments that grant exclusivity or allow firms, domestic or foreign, to erect informal impediments to the entry of other firms could contribute to the potential for such practices.

... through the adoption and implementation of competition policies.

Governments rely on several policy tools to ensure that their markets remain contestable and that competition in markets is maintained as far as possible, so that economic growth and welfare are not adversely affected by the inefficient allocation or use of resources. The tools of such policy include trade policy, FDI policy, regulatory policy with respect to domestic economic activity, and competition policy. While the first three comprise rules and regulations that serve several purposes and not only that of maintaining competition with a view to fostering efficiency, the last relates specifically to the rules and regulations — implemented by competition authorities — with respect to arrangements among firms/suppliers and the conduct of individual firms/suppliers, generally but not exclusively, in national markets. It is increasingly recognized that consistency and coherence between the different policies — some of which, as mentioned above, could serve competing objectives — are important. This is reflected in the fact that, in many developing countries, trade liberalization, FDI liberalization and domestic deregulation are currently taking place simultaneously. This ensures that the contestability and competition introduced by one set of policies are not undermined by another; but it also makes the pain of adjustment to competition, especially for hitherto protected domestic firms, a problem requiring attention and action by governments.

While the relevant markets for many products remain national in scope even in a globalizing world economy, ...

Even as barriers between national markets are reduced and producers can locate anywhere in the world (or in a region) to transact with sellers also ocated anywhere, the markets for many products

remain national in scope. These include markets for products that can only be delivered through the presence of the producer at the location of the buyer — notably, services — and markets in countries that have significant restrictions on trade. The interaction of TNCs with the structure of these national markets, the process of competition and the performance of firms and industries within host countries all therefore continue to be of interest, especially for developing countries.

... opening up to inward FDI can contribute towards the contestability of host country markets...

The opening up of economies to inward FDI can contribute directly towards increasing the contestability of — or potential competition in — host country markets. Sellers participating in these markets can now include not only domestic producers and (in the case of goods and tradable services) exporters from other countries, but also TNCs from other countries that establish affiliates (as well as contractual arrangements with other firms) to produce in and for local markets. Furthermore, TNCs, with their ownership-specific or competitive advantages, are often better able than domestic firms to overcome some of the cost-related barriers to entry that limit the number of firms in an industry and the market for its products. This potential for increasing competition by allowing FDI entry is particularly important for many service markets, in which competition through arm's length international trade is not possible or is limited.

... even though TNC activity may decrease or increase market concentration in host country markets, ...

Transnational corporations typically participate to a greater extent in industries that are more concentrated, at the national as well as the international level. This is largely due to the fact that industry concentration and the competitive advantages that enable firms to become transnational share common causes. However, inward FDI, when it takes place, can itself affect the concentration of producers in a host-country industry and, hence, of sellers in the market for its products. The nature of this effect depends, initially, upon whether or not the mode of entry is such as to add to the number of suppliers (and the quantity supplied) in a market and, subsequently,

upon several factors related to the relative size, competitive strength and mode of competition of foreign affiliates and domestic and other firms competing in a market. In developed host countries, on balance, these factors are likely to be conducive towards reducing market concentration — or, at least, not to increase concentration.

In developing economies, the picture is more complex. Although the mode of entry of FDI into developing economies — generally, greenfield investment — is conducive to reducing concentration, market concentration has often been found to increase. Several factors may be involved: the disparity in size between foreign affiliates and domestic firms; the greater production efficiency or sales capability of foreign affiliates (which can lead to the exit of domestic enterprises that have yet to build up the necessary capabilities to withstand international competition, or to their merger with foreign firms); the use of modes of competition that are new to host country markets; the introduction of new products for which no other local producers or substitutes are available; and, most importantly in the case of tradable goods and services, restrictions on international trade that give local producers protected markets. If there is a sizeable number of domestic firms that have accumulated some competitive strengths and/or the capabilities to learn from foreign firms, increased concentration is less likely. Similarly, the presence of imports can curb the possible dominance of foreign affiliates in a market. The increasing role of small and medium-sized TNCs and TNCs from developing countries, with sometimes smaller competitive advantages compared with those of large TNCs from developed countries, is also likely to contribute towards lessening the tendency towards greater concentration of host country markets in industries with substantial inward FDI.

... and influence the performance of firms and industries — and, ultimately, consumer welfare — accordingly.

The production efficiency of foreign affiliates is often higher than that of domestic firms in host developing countries. The implications of this for welfare in the host economy depend upon whether competition is maintained when FDI takes place, and markets work efficiently. If competition — between foreign affiliates

themselves, between foreign affiliates and importers, and between foreign affiliates and domestic firms — is lacking, and foreign affiliates operate in highly concentrated markets with low contestability, the benefits to consumers from the entry of more efficient TNCs, in the form of lower prices, improved quality, increased variety, as well as innovation and the introduction of new products, may be limited. In addition, there may be scope for TNCs to engage in anticompetitive business practices that serve to keep new entrants out or result in inefficiencies and reduced consumer welfare.

In particular, if a host country market remains, or becomes, concentrated after the entry of TNCs, there may be a potential for TNCs to engage in business practices, including restrictive business practices, that could have anticompetitive consequences, especially in markets that are characterized by low contestability. The main types of anticompetitive behaviour include, as in the case of purely domestic firms, collusion among producers/sellers of the same product; monopolizing mergers and acquisitions; exclusionary vertical practices; and predatory behaviour. In the case of TNCs, these practices may sometimes be specifically related to, or facilitated by, the cross-border relationships and contacts that are specific to operating in more than one country.

Consumer welfare in host country markets may also be affected adversely if market-power inducements are granted by host country governments to TNCs in order to attract investments by the latter. These inducements include guaranteed exclusive rights of production and/or exclusive rights of sale of a product in the host country market, often supported by protection in the form of prohibitive tariff or non-tariff restrictions on trade. The granting of these inducements has direct anticompetitive effects, with adverse implications for efficiency and the benefits from FDI. Such inducements, like other incentives, are based on the objective of maximizing the long-term benefits (in the form of capital, technology, management know-how, and market access) that FDI is expected to bring; but, given the potential for adverse effects on the efficient functioning of markets, a careful assessment of costs and benefits is necessary if the granting of these inducements is to be justified.

In regional and global markets, competition and efficiency can go hand in hand with greater concentration ...

In a liberalizing and globalizing world economy, TNCs operate increasingly in markets that are no longer national but regional or global in scope, with transactions between sellers and buyers of a given product from several different countries taking place across national boundaries. In various industries, TNCs take advantage of the widening scope of markets to restructure their operations and/or integrate their value-added activities internationally, either within their corporate systems or through inter-firm alliances and agreements, achieving efficiencies in production through functional specialization and economies of scale and scope.

The efficiency gains that some TNCs are able to reap through integrated international production enables them to lower prices, to introduce better quality products, or to introduce new products to capture a greater market share. This leads some industries (and markets) to become more concentrated at the regional or global level, a trend that affects all countries.

However, concentrated markets at the regional or global levels need not necessarily affect competition, industry performance or consumer welfare adversely. For one thing, such markets are, by definition, more contestable or open as regards entry (and exit) than segmented national markets, simply because sellers (and buyers) from a number of locations can participate in them. Furthermore, when integrated international production (including at the R&D stage of the value chain) for regional or global markets enables firms to overcome the high costs of, and reap the economies of scale and scope associated with innovation in industries with rapidly changing technology, it could actually enhance competition (through innovation), although the number of independent firms that perform a particular function may diminish. Consumers located in different national economies benefit when buying in those regional or global markets.

Particularly high degrees of concentration in regional and global markets would, of course, raise competition concerns. Business practices by regionally or globally dominant firms, including TNCs,

could affect the continued contestability of the relevant markets and the sustainability of the benefits that the greater openness to FDI and trade is expected to bring.

... and can be further enhanced by a quick supply response through FDI.

In today's world economy, a number of factors facilitate the ease and speed with which TNCs can provide a supply response to a change in market conditions — signalled, for example, by a non-transitory price increase — through the establishment of new production facilities to enter a market. These factors are based on the reality that nearly all countries seek to attract FDI, many firms already have foreign affiliates in place, technological developments make the establishment of new affiliates relatively easy and competitive pressures often make the exploitation of new opportunities irresistible. More specifically, the supply response of many TNCs could be rapid, rivalling that of domestic producers and importers in a country because of the scanning capabilities of TNCs; their experience in trade and FDI; their access to resources within and outside their corporate systems, and access to markets; their ability to spread risks and enter into alliances to overcome entry barriers such as those of R&D; and their ability to draw upon existing affiliates for assistance. If supply response through FDI and non-equity arrangements by TNCs is relatively fast — with, say, not more than one to two years elapsing between the identification of an opportunity and the servicing of a market — it would be deserving of attention when considering the degree of competition in a given market. This is particularly important with respect to competition in markets for services, many of which cannot be traded across borders. All this suggests that the speed of the supply response through FDI must therefore be considered routinely — by competition authorities in developed and developing countries alike — when defining the relevant market for a product, or assessing the implications for competition of certain changes occurring in a market.

The possibility that new FDI will provide a viable supply response underlines the growing importance of FDI as a factor influencing contestability. Markets may not, however, always

continue to remain contestable and competitive. This has several policy implications.

While FDI liberalization can be a means of promoting competition ...

The liberalization of FDI regimes facilitates market entry and, therefore, can increase the contestability of markets. As the liberalization process advances, non-traditional barriers that may inhibit FDI are attracting the attention of policy makers. While some of these barriers are due to government measures (e.g., in the case of public monopolies), others — and these are receiving increasing attention — concern anticompetitive private business practices (which include many restrictive business practices). Some of the latter are normally prohibited *per se* (e.g., some horizontal cartels or vertical price fixing). The situation becomes more difficult when the practices concerned may have anticompetitive effects but are not considered illegal under the laws of the country in which they occur. While such practices do not necessarily discriminate between domestic and foreign firms, they may nevertheless constitute barriers to competition.

Furthermore, care must be taken that, in their eagerness to attract FDI, governments do not agree to market-power inducements which, by their very nature, restrict competition and reduce contestability. To avoid such situations, the trade-offs between the benefits associated with new FDI on the one hand, and the immediate costs of such inducements in terms of reducing economic welfare due to their anticompetitive effects, on the other hand, need to be identified as clearly as possible. Once a decision has been made that market-power inducements are required, another difficult task is to determine how much market power needs to be given away, for how long and for what range of activities, in order to attract a particular investment. A number of options exist that can be utilized to minimize negative effects:

- creating pre-entry competition (auctioning);
- circumscribing exclusivity in terms of time;

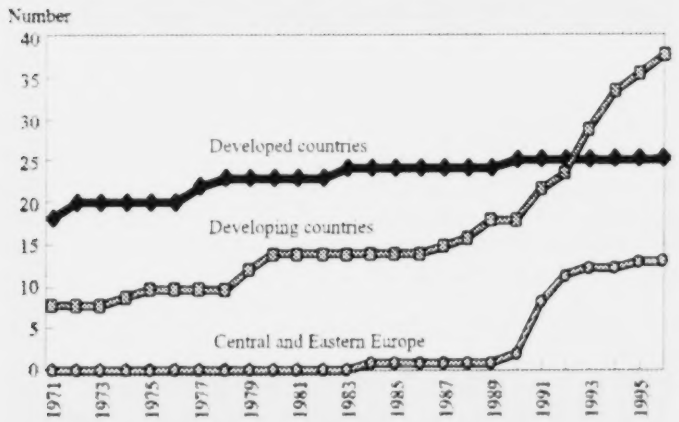
- circumscribing exclusivity through alternative sources of competition;
- ensuring fair and non-discriminatory access to essential facilities;
- breaking-up national monopolists into regional firms;
- periodically reviewing inducements by competition authorities; and
- regulating prices under certain circumstances.

In sum, the inherently anticompetitive nature of market-power inducements calls for their cautious scrutiny.

... the specific task of competition policy is to promote efficiency in a given market,...

By 1997, some 60 countries worldwide had competition laws (figure 6). Their main objective is to preserve and promote competition as a means of maximizing the efficient allocation of resources in an economy, resulting in the best possible choice of quality, the lowest prices and adequate supplies for consumers. Most competition laws

Figure 6. Number of countries with competition laws, 1971-1996



Source: UNCTAD, *World Investment Report 1997*, p. 189.

deal with enterprise *behaviour* by prohibiting restrictive business practices such as competition-restricting horizontal agreements and abuses of dominant positions, as well as certain restrictive vertical distribution agreements. Moreover, an increasing number of competition laws deals with alterations in the *structure* of markets through the control of mergers and acquisitions, as well as joint ventures, with the aim of avoiding the creation of dominant positions or even oligopolies. Usually such cartel practices as price fixing, collusive tendering and market allocation are prohibited without need for market analysis, while distribution, joint ventures and M&As agreements are assessed in a market context and under a rule-of-reason standard in terms of efficiencies likely to be achieved and passed on to consumers.

Competition laws normally apply to all firms operating in given national territories, whether through domestic sales, imports, foreign affiliates or non-equity forms of FDI. (They may also, sometimes controversially, be applied when extra-territorial operations have an effect on those given territories.) They do not, in principle, discriminate between national and foreign firms or between firms from different national origins. In this manner, competition law monitors the competitive behaviour of TNCs having effects in host countries, with a view to ensuring that these firms (like other firms) do not abuse market power. On a wider geographical scale, competition law is intended to prevent inefficiencies stemming from market-allocation agreements designed to lessen trade or investment.

Some of these agreements take the form of international market-allocation investment cartels that include promises not to invest in certain markets or not to compete when investing. By their very nature, such cartels directly restrict competition through FDI, typically to the detriment of host countries, and therefore require the attention of competition authorities.

... with the main interface between competition law and FDI taking place at entry through merger review ...

Usually, however, the main interface between competition law and FDI occurs when foreign entry is accomplished by means of a significant merger, acquisition or joint venture. Indeed, countries are

increasingly adopting merger-control regulations. Because M&As are dependent on current stock values and are difficult to unscramble once consummated, merger control of such transactions requires a carefully calibrated system of prior notification, rapid analysis, temporary injunctions and prompt decisions. Most countries use turnover or other thresholds to exempt transactions unlikely to have anticompetitive effects in order to minimize unnecessary interference and limit the number of cases screened by the competition authorities.

Most interventions by competition authorities occur in the case of horizontal M&As between competitors. Typical scenarios likely to raise competition issues are:

- The acquiring firm was exporting to a market before it acquired a competing firm in the market, or a foreign firm that already controls one firm in the market acquires another.
- A foreign firm uses FDI to set up a major plant in a market, another firm does the same, and then the two agree to merge (or one takes over the other), thereby eliminating local competition between their two affiliates.
- When a foreign firm enters a market by means of a joint venture with a local firm, the issue arises as to whether the foreign firm would have been likely to have entered the market separately and competed with the local firm in the absence of the joint venture.
- The possibility that the acquiring firm will have an incentive to suppress rather than develop the competitive potential of the firm to be acquired.
- The merger of two foreign parent firms can sometimes create competition issues in countries other than the home or host countries of the merging firms, i.e., third countries.
- A parent firm acquires an enterprise abroad which, as an independent entity, is (or could be) a source of competition for the domestic market.
- Investments likely to lead to, or augment, worldwide dominant positions. Such cases typically arise in

situations in which a transaction affects product markets in which firms compete at the regional or global level.

...and in the context of post-entry competition issues.

While the liberalization of FDI and trade regimes can be a means of promoting competition, the possibility of anticompetitive practices by firms requires the continuous attention of competition authorities. In fact, even in a national framework in which investment and "trade" are fully liberalized, the possibility of such practices provides one of the rationales for the existence of competition laws. Therefore, while an FDI entry may be unobjectionable from a competition point of view, or even beneficial in itself, it may raise competition issues in the longer term, depending on the behaviour of the firm.

For example, competition problems may arise because of restraints that are ancillary to the basic transaction, e.g., when tied purchasing is involved. Joint ventures are particularly susceptible to the combination of a pro-competitive basic transaction and ancillary restraints. Another example, which relates to secondary effects, concerns potential competition problems that can arise if a foreign investor assumes control of an essential facility; competition authorities may have to intervene to require dealing on reasonable terms. Moreover, as transfer pricing can be used for predatory purposes, competition authorities may have to monitor events in this area as well; given the nature of this practice, international cooperation is often required.

Finally, corporate non-equity alliances pose new challenges. Certain types of research-and-development alliances, in particular, are attracting increasing attention. Such alliances can have elements of cartelization and, as such, might be subject to competition-law scrutiny. Competition authorities may intervene as regards the structure of a research-and-development arrangement, particularly if parties envisage the joint exploitation of the results. At the same time, such arrangements can have important positive implications for an economy. Many countries therefore exempt certain technological alliances from competition regulations. Where this is

not the case, a rule-of-reason standard on a case-by-case basis seems to be increasingly the prevailing approach in judicial reviews, to balance long-term efficiency gains against possible short-term anticompetitive effects.

There is a direct, necessary and enlarging relationship between FDI liberalization and the importance of competition policy ...

While FDI liberalization can help to enhance the contestability of markets, it is not a sufficient condition: in so far as FDI liberalization creates more space for firms to pursue their interests in markets, competition laws become necessary to ensure that former statutory obstacles to contestability are not replaced by anticompetitive practices of firms, thus negating the benefits that could arise from liberalization. This need increases as liberalization becomes more widespread and extends to new areas.

If anything, this underlines that the principal dimensions of the FDI liberalization process (identified in the *World Investment Report 1994*) are, indeed, inextricably linked: the reduction of barriers to FDI and the establishment of positive standards of treatment for TNCs need to go hand in hand with the adoption of measures aimed at ensuring the proper functioning of markets, including, in particular, measures to control anticompetitive practices by firms.

This also underlines something else, namely, that the culture of FDI liberalization that has grown worldwide and has become pervasive, needs to be complemented by an equally worldwide and pervasive culture of competition (which, of course, needs to recognize competing objectives as well). Clearly formulated competition policies and their effective enforcement can contribute significantly to the growth of such a competition culture. In this respect, the trend towards adopting or strengthening competition laws suggests that a competition culture is, indeed, emerging in many parts of the world. However, for countries that are new to this practice, the transition to a more open, competition-oriented system cannot be achieved overnight and involves difficult political choices, the balancing of interests among many stakeholders and the resolving of a host of practical problems.

Moving from the plane of competition culture to the plane of policy, this means that competition policy should receive increased attention when it comes to the ideal mix of relevant policy instruments. This should also be the case because, as countries liberalize their investment regimes, they may become concerned that they are moving, for example, from a system of screening all take-overs by foreign firms of national firms to screening none; they may also see risks of foreign firms acquiring dominant positions. Therefore, there is a need to assess the competitive effects of foreign firms at the time of entry and after entry, and that function is increasingly assumed, where appropriate, by competition authorities. Competition policy thus has a major role to play in the process of liberalization, notably by ensuring that markets are kept as open as possible to new entrants, and that firms do not frustrate this by engaging in anticompetitive practices. In this manner, the vigorous enforcement of competition law can provide reassurance that FDI liberalization will not leave governments powerless against anticompetitive transactions or subsequent problems.

When formulating their competition policies, countries need, of course, to keep in mind that competition policy is not a substitute for FDI policy and trade policy, but rather that all three are mutually supportive in the pursuit of efforts to ensure that markets function properly. Nevertheless, to the extent that contestability and competition considerations gain in importance in guiding policies, and the more liberal trade and FDI policies become — but, by themselves, do not always lead to contestable markets — competition policy emerges as *primus inter pares* among policy instruments used to maintain contestability and competition.

To make a difference, competition policy needs to be effectively implemented. This requires a strong competition law and an effective competition-enforcement agency, with broad powers to investigate enterprise behaviour and to analyse the competitive effects of concentrative forms of FDI and the competition implications of market-power inducements. Once the basic political decision has been made to adopt and enforce competition policy, the agency should be consulted in relevant contexts, and its enforcement decisions should not be subject to indiscriminate political intervention.

Still, it must be recognized that few countries have strong, well-functioning and well-funded competition authorities. And it may well take other countries many years to develop appropriate policies and the institutional set-up to implement them fairly and effectively. This means that, where contestability and competition are the objectives, many countries will need to continue to rely, for the foreseeable future, primarily on FDI and trade liberalization to meet these objectives in the context of closer integration into global markets.

Traditionally, competition laws, especially in developing countries, have focused mostly on protecting competition among domestic firms within the local market. When imports became important, they were included in competition analysis as well. As FDI has become more important than trade in terms of delivering goods and services to foreign markets, markets are increasingly regionalized or globalized, and national production systems are becoming more integrated through the activities of TNCs, attention now needs to expand to include the competition effects of FDI and corporate integrated international production systems, including corporate alliances. These developments have important policy implications:

- The regionalization and globalization of markets and their underlying production structures make it increasingly difficult to define and measure market concentration and to determine the emergence of dominant positions (and the possibilities of abuse of market power inherent in this) in terms of *individual national* markets alone.
- Closely related is that the efficiency gains that can be associated with corporate integrated international production systems (including alliances) need to be balanced against any anticompetitive effects of the relevant transactions for the markets supplied by these systems.
- When confronted with non-trivial and non-transitory price increases, competition authorities need to give more attention to a possible supply response through new FDI by foreign producers not yet servicing a market (in

addition to supply responses by established domestic producers and imports). Competition authorities are only beginning to consider explicitly and systematically such new FDI as a normal possible source of supply response. The FDI supply response is particularly important because, in terms of its magnitude, world sales by foreign affiliates are larger than world imports. Perhaps more importantly, FDI is often the only international supply response possible in the services sector.

... which, increasingly, also requires that competition authorities cooperate among themselves...

There are numerous reasons why — in an era of globalization — competition issues as they relate to FDI increasingly involve more than one country and, therefore, require international policy responses. Indeed, they are grounded in the very nature of the transnational character of the firms involved, and relate especially to such issues as access to information and the implementation of decisions.

However, a number of obstacles make international responses difficult. With respect to the *exchange of information*, the largest single obstacle is that of the confidentiality obligations of many competition authorities — which they need to have — regarding information submitted to them by various parties. Closer *competition-enforcement cooperation* is often impeded by basic substantive and procedural differences between the competition-law regimes of different countries; in fact, activities being investigated in one jurisdiction may have been encouraged by a government in another jurisdiction. Moreover, many governments simply may not see it in their country's interest to facilitate a foreign state's investigation of one or more of their companies.

Precisely because of such obstacles, issues relating to competition are increasingly being addressed at the international level, either in the form of separate arrangements relating to some aspects of competition policy or in the context of broader investment and trade arrangements:

Bilateral cooperation among competition authorities is growing, although formal agreements are limited to a relatively small number of countries. Most of these efforts involve cooperation on the exchange of information. A number of bilateral agreements go further by establishing ground rules for notification of competition investigations, consultations and cooperation on competition-law enforcement, including commitments for comity (e.g., to take into account whether significant interests of any foreign sovereign would be affected).

Cooperation efforts **at the regional level** often take place in the context of regional integration schemes, which allow approaches and trade-offs that are more difficult to pursue in other settings. The most integrated in this respect is the European Union, in which the member countries have agreed to common competition rules and have a common competition authority. In the OECD, efforts to cooperate on restrictive business practices are not new, with recent recommendations strengthening previous provisions and setting out guiding principles for cooperation. Efforts are also being made within the context of other regional agreements, such as NAFTA, MERCOSUR and the Energy Charter Treaty.

At the **multilateral level**, the UNCTAD Set of Principles and Rules for the Control of Restrictive Business Practices is so far the only multilateral instrument covering all aspects of the control of restrictive business practices. Various WTO agreements also touch upon aspects of anticompetitive practices by firms, including in the context of the General Agreement on Trade in Services, the Agreement on Trade-Related Aspects of Intellectual Property Rights and the Agreement on Trade-Related Investment Measures; the last of these Agreements provides for consideration to be given to whether the Agreement should be complemented with provisions on investment policy and competition policy.

Still, the question arises whether, to sustain the regionalization and globalization of markets and production structures, something more than expanded bilateral and regional cooperation is required. Indeed, recent international discussions reflect a growing recognition by the international community of the links between FDI policy, trade and competition policy. This is underlined in particular by the decision

taken at the Ministerial Conference of the World Trade Organization in Singapore in December 1996 to establish one Working Group to examine the relationship between trade and investment, and another to study issues raised by members relating to the interaction between trade and competition policy, including anticompetitive practices, in order to identify any areas that may merit further consideration in the WTO framework. As furthermore stated in the Ministerial Declaration, these Working Groups are to draw upon each other's work if necessary and also to draw upon the work in UNCTAD and other appropriate intergovernmental fora.

...while recognizing that the pursuit of contestability does not necessarily always lead to desired outcomes, especially where development considerations weigh heavily.

While FDI liberalization can increase competition in markets and thereby contribute to economic efficiency, growth, development and, ultimately, consumer welfare, there are limitations to competition. They arise in particular when markets tend naturally towards high level of concentration and when market outcomes conflict with other policy objectives.

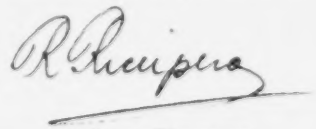
In the first instance, limitations can arise from the fact that such natural factors as economies of scale, high sunk costs and high risk-related costs can make some markets, to a greater or lesser degree, difficult to contest (although technological developments can change the importance of some of these natural factors). One of the antidotes to these natural limits to contestability involves an increase in the size of the relevant market, especially through investment and trade liberalization. Where market enlargement is difficult to achieve, regulations can help to prevent abuses of dominant positions of market power.

Limitations also arise because governments in all countries are often (if not always) faced with having to choose between competing objectives, and a number of these can conflict with the market outcomes that would be generated by reasonably competitive markets. Improving economic efficiency by making markets more competitive is subject to the same need to make choices. Competing objectives include safeguarding national security; protecting labour

rights; safeguarding culture; promoting positive externalities; protecting property rights; avoiding negative externalities; protecting consumers; and promoting development.

For developing countries, of course, the promotion of development takes pride of place. Given the particular characteristics of developing countries — low income levels, skewed distribution of wealth, insufficient infrastructure, low levels of education, asymmetries in information, to mention but a few — the incidence of conflicts between market outcomes and competing objectives is often more frequent, especially when dynamic efficiency considerations are taken into account. Where such conflicts occur, their resolution may require creating a mix of policies that limit contestability for a given period of time and that include fade-out provisions, on the one hand, and measures to assist and encourage the building up of domestic capabilities, on the other hand. Indeed, the key issue is to help domestic firms to develop their potential, so that they can participate effectively in international competition and move up the value-added chain.

While limits to contestability may be needed to promote development, it is very difficult indeed to define general criteria on the basis of which such limits could be established. In any event, the main emphasis should remain on establishing, where possible, functioning markets. When limits are placed upon contestability, there is a need to achieve the right balance between efficiency and non-efficiency objectives in a dynamic context. Exceptions or exemptions to contestability and competition need to be tempered by the recognition that they often entail trade-offs with efficiency. Moreover, when governments choose to circumscribe competition, the means by which they do so should be the least damaging from an efficiency perspective; should be transparent; and should be subject to review in the light of changes in markets and the original rationale for such policies.



Rubens Ricupero
Secretary-General of UNCTAD

August 1997

Annex:
World Investment Report 1997
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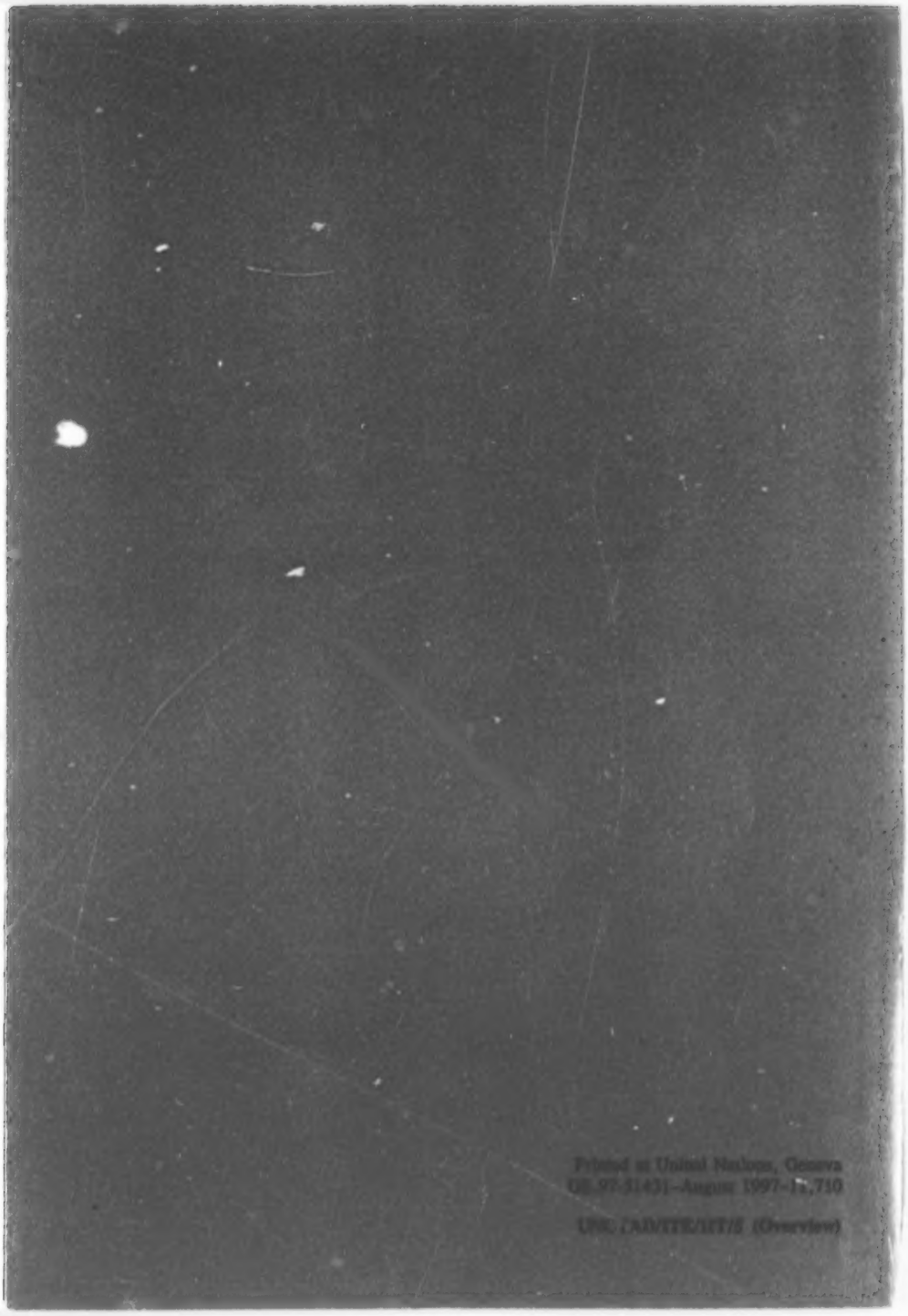

Printed at United Nations, Geneva
GE.97-51431–August 1997–[illegible],710

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